The Fiscal Implications Of The National Pharmacare Program

- The Liberal government is likely to propose the implementation of a universal public pharmacare program ahead of the upcoming Fall federal election.
- Under the proposal made by an independent Advisory Council, an initial list of essential drugs would be covered starting in 2022. That list would be significantly extended by 2027.
- The federal government would transfer (pay) the provinces for the incremental costs associated with the implementation of pharmacare. Therefore, it would have a net neutral impact for all provinces
- In dollar terms, all else equal, this would moderately increase the federal government's deficit over time. As a share of GDP, the federal deficit would remain unchanged from its FY 2017-18 level at 0.9%.
- Large discrepancies in currently available provincial pharmacare programs imply different incremental costs from one province to another. Therefore, to level the playing field in terms of pharmacare coverage for all Canadians, provinces have to receive "unequal" federal transfers. The jurisdictions already covering a larger share of the hypothetical pharmacare program will receive proportionally less than the others.
- To avoid a contentious issue, the federal government could decide to cover a bigger share of pharmacare costs, shifting some of the growing health care costs burden from provinces to Ottawa.

In Budget 2018, the government of Canada put in place an *Advisory Council* on the implementation of a national pharmacare program. The *Advisory Council*, led by former Ontario Minister of Health Dr. Eric Hoskins, submitted its final report to the federal government on June 12th. The Council recommended the implementation of a universal, single-payer public pharmacare system. As such, pharmacare is expected to be part of the fall election campaign. Replacing a large part of the complex network of over 100 public prescription drug plans and 100,000 private plans by a universal public system would be one of the most significant changes to health care in Canada since the passage of the 1984 *Canada Health Act*.

The current federal initiative has two intertwined goals. The first one is to **lower the cost of prescription drugs** in the country. This will be done through the creation of a Canadian drug agency at a relatively minor cost of $35M over four years and by increasing the use of generics. Right now, provincial public plans and private plans are negotiating drug prices individually with pharmaceutical companies.[1] Since the Agency will be positioned as a single buyer for all prescription drugs covered under pharmacare, it will have a greater ability to negotiate lower prices.

The second goal is to **improve access to prescription drugs.** The Advisory Council's proposition is to begin the national pharmacare program in 2022 with a list of essential medicines to be covered publicly in all provinces and territories. This list will be expanded during the following five years. In addition to providing coverage to all Canadians, access will be improved through limited co-payments (out-of-pocket amounts consumers pay at the pharmacy).[2]

Bond investors should take note of this policy's sizeable fiscal implications. First, the federal government would assume a significant share of the program's currently envisioned costs, therefore deteriorating Ottawa's financial

[1] The pan-Canadian Pharmaceutical Alliance, created in 2010 to improve negotiating power, is already negotiating some drugs on behalf of the provinces, territories and the federal government.

[2] Copayment will vary from 2$ for essential medicines and 5$ for other drugs. Also, annual copayment is limited to 100$ per household.

situation. Second, the public pharmacare program is a federal initiative in a field in which provinces have constitutional authority. Introducing a universal pharmacare program would therefore have important federal-provincial implications. This report examines those two aspects.

The magnitude of the impact on federal public finances will depend on the chosen formula

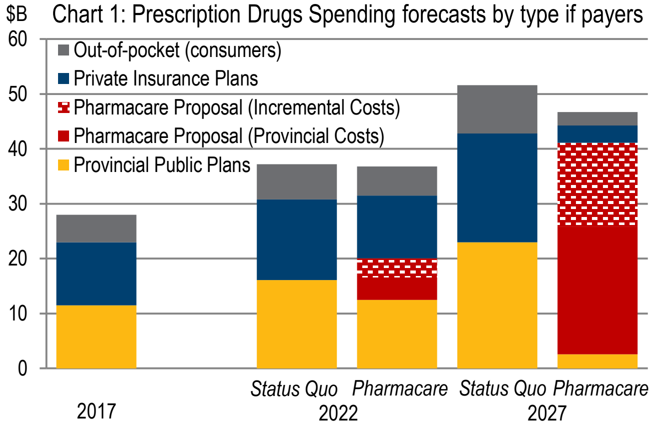
Under the Council's recommendation, the federal government would assume the *incremental costs* of implementing pharmacare through a new dedicated federal transfer. Incremental costs stem from the fact that provinces already cover a portion (either small or large, depending on the jurisdiction) of the list of prescription drugs that would be included in pharmacare. The Council's proposal is the following: drugs not already covered by provincial public plans would be covered and paid by the federal government so that each province and territory is able to provide equal benefits to its population.

To assess the policy's financial impact, the Council forecasts pharmacare spending by type of payers (public sector, private sector and patients) and compares it to a status quo scenario in which no pharmacare is implemented (chart 1). The Council's model incorporates system-wide effects such as improved bargaining power (as explained above), reduced administrative costs, higher generic substitutions and improved prescription filling. The expected system-wide savings on drug spending are of $0.3B in 2022, relative to a status quo scenario without pharmacare. In 2027, those system-wide savings could increase to $5B.[3]

In this scenario, the Council uses the Canadian CLEAN list of essential medicine. It includes 136 primary care medicines and represents 42% of overall drug prescriptions. Based on this model, the cost of covering the essential medicine list would be $7.6B in 2022 (chart 1, full and dashed red bars in 2022).[4] Of the $7.6B, the incremental cost paid by the federal government would be small at $3.5B (chart 1, dashed red bar in 2022). The remaining $4.1B is already included in existing provincial public plans (chart 1, full red bar in 2022).

Pharmacare will get more expensive when fully implemented in 2027. In the extended list scenario, the Council uses Quebec's Régie de l'Assurance Maladie (RAMQ)'s formulary and expands it to the entire country. The RAMQ's coverage is the most extensive among provincial public plans: 900 drugs representing 87% of total prescriptions. The total pharmacare cost is $38.5B.[5] The incremental cost is much larger at $15.3B (chart 1, dashed red bar in 2027).

Chart 1: Prescription Drugs Spending forecasts by type if payers



Note: Net of confidential rebates and other potential savings.
Source: Final report of the Advisory Council on the Implementation of National Pharmacare.

[3] System-wide savings is defined as lower private, public and out-of-pocket spending.
[4] This represents 21% of the total $36.8B forecast prescription drug spending and is net of system-wide spending.
[5] This represents 82% of the total $38.5B total forecasted prescription drugs spending and is net of system-wide spending.

To give an idea of the magnitude of the policy's fiscal impact on the federal government, we added the incremental costs ($3.5B in 2022 and $15.3B in 2027) to a basecase projection of the federal deficit.[6] In 2022, pharmacare yields a small deterioration in the federal government's deficit, from $12.1B (0.5% of GDP) to $15.6B (0.6% of GDP) (chart 2). Once the pharmacare program is fully implemented in 2027, the fiscal impact becomes larger: from a basecase deficit of $13.1B (0.4% of GDP) to $28.4B (0.9% of GDP). Essentially, the pharmacare program would double the deficit's dollar size in FY 2027-28 relative to the status quo. It would also show no improvement as a share of GDP relative to FY 2017-18. However, it is important to stress that at 0.9% of GDP, the federal deficit would still be manageable under the assumption that moderate economic growth continues. It also assumes no other changes to revenues and other types of spending.

Chart 2A: Federal Deficit With And Without Pharmacare
($ Billion)

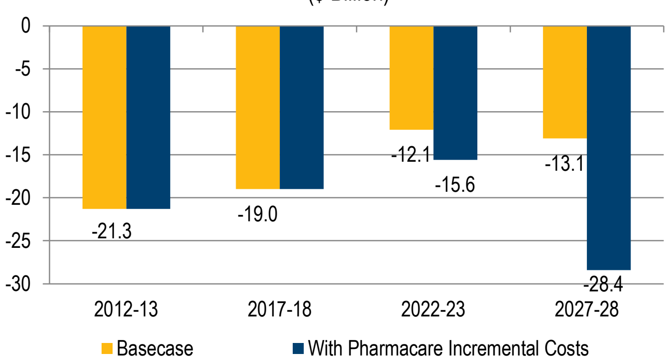
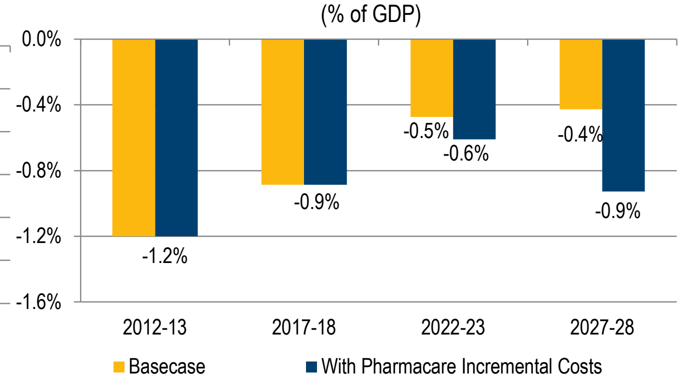


Chart 2B: Federal Deficit With And Without Pharmacare
(% of GDP)



Note: Basecase fiscal forecast uses Budget 2019 medium-term projections and Finance Canada December 2018 long-term projections.
Source: Advisory Council on Pharmacare, Government of Canada and LBS Econ. Res. and Strategy calculations.

A potentially complicated federal-provincial arrangement

The proposed design

Under the Council's proposal, each province would receive a recurrent annual federal transfer to cover the incremental costs associated with the pharmacare program. In other words, it is designed to have a net neutral impact in the long run for provincial finances. The calculated federal transfer ranges from $25M in Prince Edward Island (PEI) to $1.3B in Ontario in 2022. It would increase to $104M and $6.0B in 2027, respectively (Table 1). To be sure, federal transfer to each province reflects more than the simple fact that some jurisdictions are more populous than others, but take into account the large disparities in provincial public coverage currently in place. Indeed, the number of prescription drugs covered by plans, the percentage of the amount per drug covered, eligibility, restrictions, copayments and deductibles vary. Also, there are different options offered to seniors, low-income household and children, depending on the province.[7]

Therefore, as a share of total public spending under pharmacare, provinces with less expanded drug coverage will incur larger incremental costs than others, thereby proportionally receiving a larger federal transfer. To provide equal benefits to the population in 2027, the Atlantic Provinces would receive more than 60% of total public spending under pharmacare from the federal government (chart 3).[8] In comparison, these ratios would only be 38% and 42% in

[6] The basecase fiscal forecast combines Budget 2019 medium-term projections and Finance Canada December 2018 long-term projections. The forecast is not intended to produce precise estimates but rather give an order of magnitude of the policy's fiscal impact.
[7] For more details on provincial disparities in current pharmacare programs, see Table 1, 3, Figure 6 and Annex 4 of the Final Report of the Advisory Council of the Implementation of National Pharmacare.
[8] Except Nova Scotia at 58%.

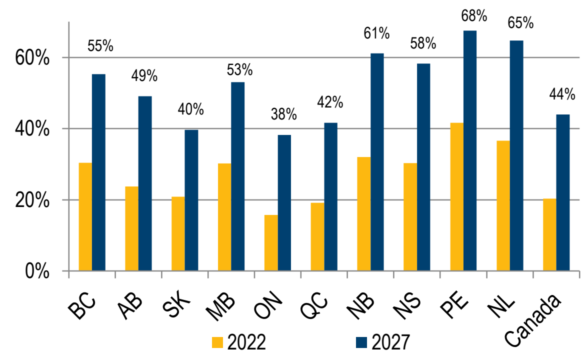
Ontario and Quebec. Western provinces (British Columbia, Alberta and Saskatchewan) are in the middle of the pack at 55%, 49% and 40% respectively.

Table 1: Incremental Costs and Total Projected Public Spending in 2027 Under Pharmacare (By Province)

$M	*Incremental Costs*	*Total Public Spending*
ON	6,040	15,785
QC	5,122	12,293
BC	2,154	3,893
AB	2,040	4,157
MB	606	1,142
NS	625	1,073
NB	579	947
SK	429	1,081
NL	399	616
PE	104	154

Note: Total public spending include incremental costs, current provincial coverage of what would be national pharmacare and provincial additional coverage beyond pharmacare. Source: Table 9 of the Final report of the Advisory Council on the Implementation of National Pharmacare.

Chart 3: Net Incremental Costs (Federal Transfer) as a share of total public spending under pharmacare



Note: Net of copayments.
Source: Table 8 and 9 of the Final report of the Advisory Council on the Implementation of National Pharmacare and LBS Econ. Res. and Strategy calculations.

The asymmetry

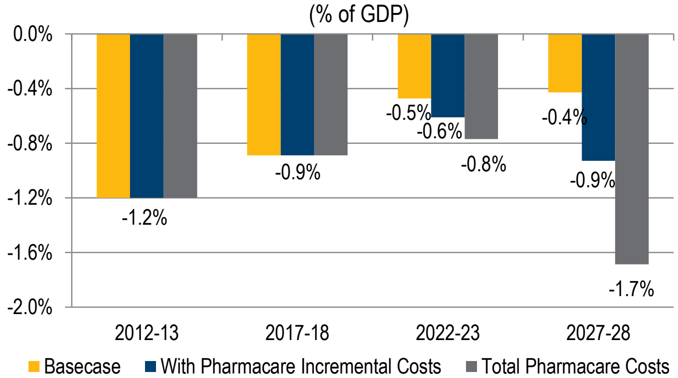
In an analysis of the Advisory Council pharmacare proposal, the Institute For Research on Public Policy (IRPP) shared some concerns about this mechanism. Essentially, the transfer is asymmetric. While relative to the status quo scenario, the net fiscal impact for each province would be neutral, the variance in proportionality might not satisfy the provinces that face below-average incremental costs. This issue complicates the inevitable one-on-one negotiations between each province and the federal government for the adoption of universal pharmacare and threatens country-wide adoption. A province would not strike a deal if its negotiated terms were not as beneficial as in another province. As the IRPP points out, the asymmetry is also contradictory to another recommendation of the Report which is that “Provinces and territories that have already made substantial investments in prescription drug coverage should not be penalized for their contributions”.

Other alternatives to the Council’s proposal

The Advisory Council Report is yet a proposal. The exact policy has not been set in stone. For instance, while the NDP is already proposing universal pharmacare, the Conservative Party (CPC) has criticized the plan’s costs. The CPC has mentioned that it would instead, if elected, focus on filling the coverage gaps in the system.

Moreover, the current Liberal government (and the next one, if re-elected) could set up a different provincial-federal arrangement to finance pharmacare. One alternative to avoid discontent would be to share the pharmacare envelope among Provinces the same way that the current Canada Health Transfer (CHT) is: per capita. But provinces facing larger incremental costs to implement pharmacare, in the Atlantic region for example, might not see the benefits to opt-in. They would receive a lower transfer under a per capita formula. Another way would be for the federal government to expand its contribution beyond incremental costs. As a rather extreme example, the federal government could cover *all* pharmacare costs, which would basically double the annual tally of the total federal transfer to $7.6B in 2022 and $38.5B in 2027 (in comparison, the total envelope for the Canada Health Transfer stands at $40.3B and at $14.6B for the Canada Social Transfer in FY 2019-20). This would create a net positive transfer to the provinces and not disfavor the ones already heavily investing in pharmacare. Accordingly, the fiscal burden associated to public drug coverage would be transferred to the federal government. **Under this hypothetical scenario**, we estimate that the federal deficit would increase from 0.8% of GDP in FY 2022-23 to a rather large 1.7% of GDP in FY 2027-28 (chart 4, grey bar). On the one hand, the long-term sustainability of the federal government's public finances would need to be re-evaluated. Indeed, health care costs will continue to grow faster over the next decade. On the other hand, the share of the federal government's contribution to health care costs is projected to decline over the next decade. Hence, a larger-than-expected involvement in pharmacare financing would restore some balance as provincial governments will struggle to meet rising health care costs associated with an aging population.

Chart 4: Federal Deficit With A Larger Federal Involvment
(% of GDP)



Note: Basecase fiscal forecast uses Budget 2019 medium-term projections and Finance Canada December 2018 long-term projections
Source: Adivsory Council on Pharmacare, Government of Canada and LBS Econ. Res. and Strategy calculations

Dominique Lapointe | Economist
514 350-2924 | lapointed@vmbl.ca